

**REPORT OF THE AUDIT OF THE  
KNOTT COUNTY  
FISCAL COURT**

**For The Fiscal Year Ended  
June 30, 2004**



**CRIT LUALLEN  
AUDITOR OF PUBLIC ACCOUNTS  
[www.auditor.ky.gov](http://www.auditor.ky.gov)**

**105 SEA HERO ROAD, SUITE 2  
FRANKFORT, KY 40601-5404  
TELEPHONE (502) 573-0050  
FACSIMILE (502) 573-0067**



## **EXECUTIVE SUMMARY**

### **AUDIT EXAMINATION OF THE KNOTT COUNTY FISCAL COURT**

**June 30, 2004**

The Auditor of Public Accounts was engaged to audit the financial activities of the Knott County Fiscal Court for fiscal year ended June 30, 2004 and we have issued a disclaimer of opinion thereon. In accordance with OMB Circular A-133, we have issued an adverse opinion on the compliance requirements that are applicable to Knott County's major federal program, Federal Emergency Management Agency (FEMA), for the year ended June 30, 2004.

Based on our assessment of fraud risk, we determined the risk for fraud to be too high and we were unable to apply other procedures to overcome this fraud risk. In addition, the Fiscal Court had serious weaknesses in the design and operation of its internal control procedures and accounting functions. Furthermore, management elected to override the internal control procedures that were in place. We were unable to apply audit procedures to test for appropriate compliance with statutory, contractual, and administrative regulations as well as with federal grant agreements, Governor's Office for Local Development (GOLD) requirements, and county administrative code requirements. Because of this, we were also unable to determine if ethics violations occurred. In addition, we were denied access to fiscal court records needed to adequately conduct our procedures due to the county's failure to provide certain requested documentation. The significance of these issues, in the aggregate, prevents us from expressing an opinion and we do not express an opinion on the financial activities of the Knott County Fiscal Court.

#### **Report Comments:**

2004-01	Knott County Fiscal Court Failed To Oversee Coal Severance Project
2004-02	Knott County Fiscal Court Purchased Pool Property From Related Parties
2004-03	Knott County Fiscal Court Overpaid Pool Contractor By \$105,331
2004-04	Knott County Fiscal Court Did Not Follow Competitive Bidding Requirements For Federal Or County Projects And Contracts Not Bid Were Paid \$137,477 To Related Parties
2004-05	Knott County Fiscal Court Spent \$41,764 For Work On Private Property
2004-06	Knott County Fiscal Court Paid For Culverts Provided By County And Installed On Private Property As Well As Paid For Excessive Hours To A Related Party Contractor
2004-07	An Altered Invoice Was Submitted To Knott County Fiscal Court And Subsequently Paid
2004-08	County Employees Used The County Judge/Executive's Credit Card
2004-09	The County Judge/Executive's Salary Was Overpaid By \$2,452
2004-10	The County Failed To Comply With The Governor's Office For Local Development Reporting Requirements And Kentucky Revised Statutes Related To Financial Reporting, Management, Investment And Protection Of County Funds
2004-11	The Jailer Did Not Comply With State Laws Regarding Jail Canteen Operations
2004-12	Knott County Fiscal Court Should Improve Internal Controls Over County Vehicles
2004-13	Approximately \$7.8 Million Of Assets Are At Risk Due To Inadequate Insurance Coverage
2004-14	Knott County Fiscal Court Paid A Significant Portion Of County Funds To A Single Contractor
2004-15	Knott County Fiscal Court Financial Management, Expenditure Documentation, And Payment Procedures Are Inadequate
2004-16	The County Does Not Maintain Proper Documentation For Capital Assets
2004-17	Fiscal Court Should Improve Policies and Procedures Related To The Schedule Of Expenditures Of Federal Awards

EXECUTIVE SUMMARY  
AUDIT EXAMINATION OF THE  
KNOTT COUNTY FISCAL COURT  
June 30, 2004  
(Continued)

**Report Comments:** (Continued)

- |         |   |
|---------|---|
| 2004-18 | Knott County Fiscal Court Has Questioned Costs Of \$893,300 Of Federal Emergency Management Agency Funds Due To Failure To Comply With Federal A-102 Common Rule Requirements |
| 2004-19 | Knott County Fiscal Court Made A Duplicate Payment To A Contractor In The Amount Of \$19,760 For Federal Emergency Management Agency Work                                     |
| 2004-20 | Knott County Fiscal Court Did Not Earmark \$46,576 Of Federal Receipts Or Provide \$10,787 In Matching Funds For Federal Expenditures   |
| 2004-21 | The Knott County Fiscal Court Did Not Maintain Proper Supporting Documentation For Federal Funds Resulting In Questioned Costs of \$415,767 For The July 2001 Disaster        |

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**CRIT LUALLEN**  
**AUDITOR OF PUBLIC ACCOUNTS**

To the People of Kentucky

Honorable Ernie Fletcher, Governor

Robbie Rudolph, Secretary

Finance and Administration Cabinet

Honorable Donnie Newsome, Former Knott County Judge/Executive

Members of the Knott County Fiscal Court

Independent Auditor's Report

We were engaged to audit the financial activity contained in the Fourth Quarterly Report of Knott County, Kentucky, as of and for the year ended June 30, 2004. The financial activity is the responsibility of the Knott County Fiscal Court.

The financial activity contained in the Fourth Quarterly Report is intended to present budgeted and actual revenues and expenditures of the Knott County Fiscal Court on the cash basis of accounting and also the long-term debt of the Fiscal Court. Actual revenues and expenditures are recognized when received or paid rather than when earned or incurred. The presentation of the financial activity contained in the Fourth Quarterly Report is not intended to be a presentation in conformity with generally accepted accounting principles.

Based on our assessment of fraud risk, we determined the risk of fraud to be too high, and we were unable to apply other procedures to overcome this fraud risk. In addition, the Fiscal Court had serious weaknesses in the design and operation of its internal control procedures and accounting functions. Furthermore, management elected to override the internal control procedures that were in place. We were unable to apply audit procedures to test for appropriate compliance with statutory, contractual, and administrative regulations as well as with federal grant agreements, Governor's Office for Local Development (GOLD) requirements, and county administrative code requirements. Because of this, we were also unable to determine if ethics violations occurred. In addition, we were denied access to Fiscal Court records needed to adequately conduct our procedures due to the county's failure to provide certain requested documentation. The significance of these issues, in the aggregate, prevents us from placing any reliance on the financial activities contained in the Fourth Quarterly Report of the Fiscal Court.

Because we were unable to place reliance on the accuracy, validity, and completeness of the county's Fourth Quarterly Report and because audit risk is at an unacceptable level, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial activity contained in the report referred to in the first paragraph.

We were engaged to audit the financial activity of the Fourth Quarterly Report of the Knott County Fiscal Court for the purpose of forming an opinion and have disclaimed an opinion on the information. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments and Non-Profit Organizations, and is not a required part of the Fourth Quarterly Report. The scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the schedule of expenditures of federal awards.



To the People of Kentucky  
 Honorable Ernie Fletcher, Governor  
 Robbie Rudolph, Secretary  
 Finance and Administration Cabinet  
 Honorable Donnie Newsome, Former Knott County Judge/Executive  
 Members of the Knott County Fiscal Court

In accordance with Government Auditing Standards, we have also issued our report dated September 27, 2005 on our consideration of Knott County, Kentucky's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Based on the results of our audit, we present the schedule of findings and questioned costs, included herein, which discusses the following report comments:

2004-01	Knott County Fiscal Court Failed To Oversee Coal Severance Project
2004-02	Knott County Fiscal Court Purchased Pool Property From Related Parties
2004-03	Knott County Fiscal Court Overpaid Pool Contractor By \$105,331
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2004-19	Knott County Fiscal Court Made A Duplicate Payment To A Contractor In The Amount Of \$19,760 For Federal Emergency Management Agency Work



To the People of Kentucky  
Honorable Ernie Fletcher, Governor  
Robbie Rudolph, Secretary  
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Honorable Donnie Newsome, Former Knott County Judge/Executive  
Members of the Knott County Fiscal Court

2004-20      Knott County Fiscal Court Did Not Earmark \$46,576 Of Federal Receipts Or Provide  
                 \$10,787 In Matching Funds For Federal Expenditures  
2004-21      The Knott County Fiscal Court Did Not Maintain Proper Supporting Documentation  
                 For Federal Funds Resulting In Questioned Costs of \$415,767 For The July 2001  
                 Disaster

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Crit Luallen", with a long horizontal flourish extending to the right.

Crit Luallen  
Auditor of Public Accounts

Audit fieldwork completed -  
September 27, 2005



## KNOTT COUNTY OFFICIALS

For The Year Ended June 30, 2004

### **Fiscal Court Members:**

Donnie Newsome	Former County Judge/Executive
Ronnie Adams	Magistrate
Keith Combs	Magistrate
Walter Combs	Magistrate
James Huff	Magistrate

### **Other Elected Officials:**

Randy Slone	County Attorney
Eldon Hicks	Jailer
Kenneth Gayheart	County Clerk
Carlos Jake Huff (Deceased)	Former Circuit Court Clerk
Ray Bolen	Sheriff
Edward Slone	Property Valuation Administrator
Jeff Blair	Coroner

### **Appointed Personnel:**

Mac Combs	Deputy Judge/Executive
Debra Moore	Former County Treasurer
Turner E. Campbell	Former Finance Officer

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**KNOTT COUNTY FISCAL COURT  
FOURTH QUARTER FINANCIAL STATEMENTS**

**For The Year Ended June 30, 2004**

**(UNAUDITED)**

**Due to file size limitations, the financial statements are not presented here.  
Please [click here](#) to go to the financial statements.**



**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**For The Year Ended June 30, 2004**





**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

**Fiscal Year Ended June 30, 2004**

**A. SUMMARY OF AUDIT RESULTS**

1. The auditor's report expresses no opinion on the financial activity of Knott County, Kentucky.
2. Six (6) reportable conditions relating to the internal control over financial reporting are reported in the Independent Auditor's Report.
3. Eleven (11) instances of noncompliance material to the financial activities of Knott County were disclosed during the audit.
4. One reportable condition relating to the audit of the major federal awards programs is reported in the Independent Auditor's Report.
5. The auditor's report on compliance for the audit of the major federal awards programs for Knott County expresses an adverse opinion.
6. There are four (4) audit findings relative to the major federal award program for Knott County reported in Part C of this schedule.
7. The program tested as a major program was: Federal Emergency Management Agency (FEMA) CFDA #97.036.
8. The threshold for distinguishing Type A and B programs was \$300,000.
9. Knott County was not determined to be a low-risk auditee.

**B. FINDINGS – FINANCIAL STATEMENT AUDIT**

**STATE LAWS AND REGULATIONS**

**Reference Number 2004-01**

**Knott County Fiscal Court Failed To Oversee Coal Severance Project**

Since April 20, 2001, Knott County has received \$1,250,000 of coal severance funds and expended \$1,204,988 of coal severance funds toward a pool project. Costs for this project increased by 195% over original design and as of the date of this report, the pool is not usable and has remained in its current unfinished state for over a year. The original bid for this project was \$408,500. Change orders typically are utilized to authorize changes to a contract agreement including modification in the scope of work to be performed, as well as either increasing or decreasing the cost of a project. These change orders should be approved by Fiscal Court prior to the work being performed. The total amount of increased costs resulting from the change orders for this project was \$489,166. Change orders #1 through #8 for the pool project were dated from October 20, 2002 through September 18, 2003 totaling \$247,825. The Fiscal Court did not approve these change orders until December 23, 2003. As of the date of this report, the Fiscal Court has not approved change orders #9 and #10 totaling \$241,341. These change orders (#9 and #10) were processed by the Deputy Judge/Executive and Former County Treasurer and paid to the construction manager.

It appears these transactions were processed without the Fiscal Court having a full understanding that by approving the payment of these claims the project cost was exceeding the original intended cost.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

STATE LAWS AND REGULATIONS (Continued)

**Reference Number 2004-01 (Continued)**

Knott County Fiscal Court Failed To Oversee Coal Severance Project

The following is a list of significant vendors awarded contracts on the pool project, and the amounts paid to those vendors from February 20, 2001 through April 13, 2005:

Mountain Consultants	\$	167,429
Eagle Construction		932,016
Recreonics Incorporation		41,552
Natare Corporation		45,429
Other Expenditures		<u>18,572</u>
 Total Expenditures	 *	 <u>\$ 1,204,998</u>

\*The above amount does not include \$135,000 of county funds used for the land acquisition.

Knott County officials initially informed audit staff that the change orders resulted from the entrance to the property being put in the wrong place. The first entrance was constructed on property owned by the County Attorney and the former County Treasurer's brother. The entrance was moved and the new entrance was allegedly still constructed on the right-of-way again thought to be owned by the County Attorney and the former County Treasurer's brother. Through interviews with the project manager and construction manager, auditors were informed that the scope was changed at the request of the county officials to alter the project in order to include a bowling alley. To accommodate this request, the main building had to be relocated causing a major change to the pool pipe system, which increased the cost.

The scope of work reflected on the change orders #1 through #8 included grading and removal of rock, debris removal from the entrance and access roads, design and bidding of a bowling alley, installing a new entrance road with drain, deleting pool change area and mechanical room, adding additional concrete walls and concrete ditch, and backfill of stone for retaining walls. Change order #9 added a water pump, water slide, raindrop, pool lights, concrete pool deck, outside lighting, steel fencing, storm water piping, fill-in for pool deck, and pool fence. Change order #10 consisted of a retaining wall with footer, backfill with stone, paved concrete ditch, storm drain, water line and meter pit, and concrete apron. According to the construction manager, the pool house was part of the original design, but was not constructed because of the need to build the retaining wall, which became necessary due to new site location.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

STATE LAWS AND REGULATIONS (Continued)

**Reference Number 2004-01 (Continued)**

Knott County Fiscal Court Failed To Oversee Coal Severance Project

The last pay request received from the project manager stated this project was 99.4% complete; however, there are several tasks that remain incomplete including but not limited to a concrete pad, installation of pool filter equipment, installation of exterior lighting and construction of a pool house. The Fiscal Court retained \$5,000 out of the last pay request; documentation noted this was due to the project being stopped. It is estimated that between \$50,000-\$100,000 will be needed to complete this project. On June 15, 2005, the Knott County Judge/Executive informed audit staff that another construction firm had already been selected to complete this project and work would commence upon receipt of additional funds from the Governor's Office for Local Development (GOLD).

The Fiscal Court should approve change orders in a timely manner and be fully informed of major modifications or cost increases of a project. Sound management practices dictate that reasonable efforts be made by the Fiscal Court to oversee the construction and completion of this facility. Without sound management oversight, the Fiscal Court risks the loss or misappropriation of assets.

We recommend the County Attorney or Attorney General review these change order transactions for appropriateness, and to determine if county officials acted outside the scope of their authority, and if so, whether their acts resulted in invalid transactions, possibly entitling the Fiscal Court to restitution. The County Attorney or Attorney General should investigate whether the project was completed according to the contract and approved change orders, and take all necessary steps to rectify this situation. In addition, the County Attorney or Attorney General should review and take appropriate action to limit the County's liability and potential liability for injuries, which could arise from the incomplete pool project. Finally, GOLD should be notified in writing of all resolutions to these findings. We further recommend that in the future, the Fiscal Court have a clear plan and understanding of its responsibility for overseeing the construction and completion of all construction projects. Furthermore, Fiscal Court should arrange for a survey of the property to establish the boundaries originally purchased by the county and subsequently modified in recent transactions in order to verify ownership.

*County Judge/Executive Donnie Newsome's Response:*

*The initial pool project was subsequently combined and overlapped with a youth center project, that was to include a bowling alley in addition to other things for use by Knott County youth. Accordingly, it is misleading to state that the cost of the "pool project" increased by 195% without recognizing that these construction costs also reflected costs associated with the youth center project. **The actual budget for the combined project was \$1,600,987.00.** By hiring a project/construction manager, the Fiscal Court expects to obtain good guidance and advise in an area clearly outside a lay persons expertise. It is anticipated that the Fiscal Court will complete the combined project as soon as possible and will closely monitor its progress. The Fiscal Court will be asked by me to do everything within its statutory and regulatory power to comply with this audit recommendation.*

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

STATE LAWS AND REGULATIONS (Continued)

**Reference Number 2004-01 (Continued)**

Knott County Fiscal Court Failed To Oversee Coal Severance Project

*County Attorney Randy Slone's Response:*

*The County Attorney agrees to review the change order transactions and whether any of the transactions are invalid. The County Attorney also agrees to investigate, to the best of his ability and resources, whether the project was completed according to the contract and how to protect against liability for injuries from the incomplete pool and youth center project.*

**Reference Number 2004-02**

Knott County Fiscal Court Purchased Pool Property From Related Parties

During our review of the coal severance expenditures, we noted related party transactions for the purchase of the current pool property located on Hwy 160 at Perkins Madden Road. The following is a timeline of significant events:

- June 13, 2001 - Knott County Fiscal Court received an appraisal for the Hwy 160 pool property noting a fair market value of \$135,000. On this date private citizens owned this property.
- July 5, 2001 - sale of the Hwy 160 property was made between private citizens and the Knott County Attorney and the former Knott County Treasurer's brother in the amount of \$100,000.
- July 9, 2001 – Real estate mortgage was recorded by Knott County Clerk for the Hwy 160 property in the names of the Knott County Attorney and the former County Treasurer's brother. The same appraisal ordered by the Fiscal Court was used to obtain the loan.
- August 13, 2001 - Hwy 160 property was sold to the Knott County Attorney's mother for \$130,000.
- September 13, 2001 - another appraisal was completed at the request of Knott County Attorney noting the value of the pool property to be \$135,000.
- September 14, 2001 - Fiscal Court passed a resolution to purchase the Hwy 160 property from the County Attorney's mother for \$135,000
- December 11, 2001 - County Attorney's mother sold Hwy 160 property to Knott County Fiscal Court in the amount of \$135,000

The County Attorney and former County Treasurer's brother owned the Hwy 160 property for 39 days before selling to the County Attorney's mother. Fiscal Court approved the purchase of this property after 32 days, and the sale was final within 6 months. Both the project manager and construction manager stated this particular site selection significantly increased the cost of the pool project due to the need to construct a retaining wall, and to grade and remove soft soil from the site.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

STATE LAWS AND REGULATIONS (Continued)

**Reference Number 2004-02 (Continued)**

Knott County Fiscal Court Purchased Pool Property From Related Parties

Section 800 of the Knott County Administrative Code addresses ethics of county officials and employees. The Code states that any ethics complaints should be addressed by Fiscal Court, and that the County Judge/Executive should preside over the process. Section 830.1 of the Administrative Code states, “[n]o County official or County employee shall commit or participate in any action which constitutes a conflict of interest with the public trust of a County office or County employee.”

A related party transaction is a business deal or arrangement between two parties who are joined by a special relationship prior to the deal. These transactions may involve a conflict between the public and personal interest of a Knott County official.

KRS 69.210 states, “The County Attorney shall attend the Fiscal Court, conduct all business, and give legal advice.”

KRS 61.210(2) states that no County Attorney shall “directly or indirectly, receive any benefits or emoluments from, furnish any material or other thing of value to be used in, or be interested in any contract let by the fiscal court or consolidated local government for, the construction of any roads, bridges, or parts thereof, or any other public or internal improvement.”

We recommend that the Office of the Attorney General review this matter to determine whether further action is warranted. In addition, the Fiscal Court should review these related party transactions to determine if a violation of the County’s ethics policy has occurred. The County Attorney should refrain from being involved in any transaction between the Knott County Fiscal Court and himself or any family member. Finally, we recommend the Administrative Code be amended to assign an independent board to review ethics concerns.

*County Attorney Randy Slone’s Response:*

*I believed then, and am still confident now, that there was no violation of either KRS 61.210 or the local ethics code in regard to this land transaction. The sale was above-board and, in fact, made at the request of the fiscal court. A condemnation action would have added thousands, if not tens of thousands, of dollars to the project costs. Moreover, the matter was repeatedly discussed in open meetings of the fiscal court. In short, the transaction was honest and fair, and, I believe, totally legal. Nevertheless, if any similar matter again comes before the fiscal court during my remaining term of office, I will ask the Attorney General’s Office to handle the matter completely. Finally, your comments regarding amending the Administrative Code have already been suggested by me to the County Judge/Executive, and the amendment is scheduled for consideration at the next regular Fiscal Court meeting in October, 2005.*

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

STATE LAWS AND REGULATIONS (Continued)

**Reference Number 2004-03**

Knott County Fiscal Court Overpaid Pool Contractor By \$105,331

Knott County Fiscal Court paid the pool contractor \$916,016. We compared the amount paid to the contractor to the approved contract amount plus all project change orders provided by the Fiscal Court, which totaled \$897,666. This reflected an overpayment of \$18,350.

In addition, pool equipment transactions totaling \$86,981 were paid twice. First, Fiscal Court paid for equipment directly to the vendors in 2003 with coal severance money. This equipment was included in the original contract award. The project manager advised us that the pool equipment was purchased directly by the Fiscal Court to save on sales tax. Then, the pool project manager billed Fiscal Court on behalf of the contractor for the same equipment in several transactions during the project period. In correspondence dated December 14, 2004; February 9, 2005; and May 16, 2005, the project manager informed the Fiscal Court of this overpayment. However, county officials disregarded this correspondence and made the final payment to the contractor on February 25, 2005 without deducting the cost of this equipment.

Total cost due to the contractor should have been the approved contract amount plus the amounts of the change orders. Sound financial management dictates that Fiscal Court monitor the expenditures of construction projects to ensure the cost does not exceed the contract amount, and that no duplicate payments are made.

The \$18,350 overpayment from unapproved changes in addition to the duplicate payments for the pool equipment in the amount of \$86,981 reflects the total amount of overpayment of \$105,331. It should also be noted Fiscal Court did not approve change orders totaling \$241,341.

We recommend the County Attorney or Attorney General seek restitution from the contractor in the amount of \$105,331. Furthermore, we recommend that Fiscal Court implement procedures to ensure project costs are within approved amounts and ensure no duplicate payments are made.

*County Judge/Executive Donnie Newsome's Response:*

*The County Judge/Executive, after consultation with the former Treasurer and Financial Director, is not convinced that an overpayment occurred. Nevertheless, the County Judge/Executive has asked the County Attorney to review this alleged overpayment. The County Attorney agrees to investigate the alleged overpayment.*

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

**STATE LAWS AND REGULATIONS (Continued)**

**Reference Number 2004-04**

**Knott County Fiscal Court Did Not Follow Competitive Bidding Requirements For Federal Or County Projects And Contracts Not Bid Were Paid \$137,477 To Related Parties**

Based on the County's fourth quarter financial report, the Fiscal Court had \$6,254,682 of operating expenditures net of related debt, payroll and pass-through grants. A sample of 27 transactions was tested for compliance with contract bidding requirements. Of this sample, 8 out of 27 transactions were not competitively bid. Federal testing noted \$319,278 out of \$541,180 of contract expenditures was not bid, and our test of compliance and internal controls noted \$134,810 out of \$1,913,628 was not bid. Of the items tested, it should be noted that \$137,477 was paid to related parties. A related party transaction is a business arrangement between two parties who are joined by a special relationship prior to the deal. The effect of these transactions may be a conflict of interest.

The federal grant agreements require applicants comply with all applicable provisions of federal and state procurement laws and regulations. According to the County's Administrative Code, the County has adopted, in its entirety, KRS Chapter 45A, the Kentucky "Model Procurement Code" (KMPC). According to the KMPC, the County, as a local public agency, may dispense with the requirement of competitive bidding and contract or purchase through noncompetitive negotiation only when 1) a written determination is made that competition is not feasible and 2) it is determined, in writing, by a designee of the County that an emergency exists which will cause public harm as a result of the delay in competitive procedures. We found neither any written determination that competition was not feasible, nor that an emergency was declared to exist. Thus, the County did not comply with the KMPC in the payment of these expenditures.

Competitive bidding ensures that the county procures materials and service contracts at the best price available. By limiting competition, the county may not get the benefits of the best price available.

We recommend the County review and adhere to applicable laws relating to procurement. Also, Fiscal Court should review related party transactions to determine if they are in violation of the County ethics policy. A list of the related party transactions and the procurements tested, which were not competitively bid, have been forwarded to the Governor's Office for Local Development and to the Attorney General.

*County Judge/Executive Donnie Newsome's Response:*

*The county will adhere to applicable laws relating to procurement. However, the County has, if fact, complied with competitive bidding laws. FEMA instructed the County that competitive bidding was not required for emergency repairs.*

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

STATE LAWS AND REGULATIONS (Continued)

**Reference Number 2004-04 (Continued)**

Knott County Fiscal Court Did Not Follow Competitive Bidding Requirements For Federal Or County Projects And Contracts Not Bid Were Paid \$137,477 To Related Parties

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**Auditor's Reply:**

The FEMA grant agreement requires the county comply with all applicable state and local laws and regulations. Local regulations in the county's administrative code outline requirements for contracting/purchasing without competitive bidding procedures. The county adopted, as part of the administrative code, Chapter 45A "Model Procurement Code" which states that an entity may contract or purchase through noncompetitive negotiation when a written determination is made by a designee of the local public agency that an emergency exists which would cause public harm as a result of the delay related to competitive bidding procedures. The county failed to provide documentation that projects met the criteria for emergency situations as established in the administrative code; therefore, the projects were not exempt from competitive bidding procedures.

**Reference Number 2004-05**

Knott County Fiscal Court Spent \$41,764 For Work On Private Property

During our review of Federal Emergency Management Agency (FEMA) expenditures, we found that the County paid \$41,764 for contract work performed on private property. FEMA inspectors denied this expenditure after an on-site inspection. A FEMA inspector responded in two narratives, both dated September 15, 2003: The first narrative relates to Hall Branch Road. The inspector stated: "invoices included work that was not eligible [on private property]..." The second narrative relates to Salisbury Road. It states: "Field observation indicated that much of the second contractor's work was probably performed on private property, outside of the county right-of-way." The Fiscal Court paid for this work after these inspections, on February 11, 2004.

Fiscal Court should not expend public funds for work on private property.

This matter is being referred to the Office of Attorney General to determine whether further investigation is warranted as to a possible violation of KRS 522.030 - Official Misconduct in the Second Degree or other laws. Further, we recommend the County Attorney or Attorney General seek restitution from the private property owners. Finally, Fiscal Court should provide adequate oversight and monitor financial activities to ensure work is completed in accordance with applicable laws and regulations.

*County Judge/Executive Donnie Newsome's Response:*

*The County Judge/Executive does not agree that funds were expended for benefit of private property.*



**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

STATE LAWS AND REGULATIONS (Continued)

**Reference Number 2004-05 (Continued)**

Knott County Fiscal Court Spent \$41,764 For Work On Private Property

Auditor's Reply:

Written notations by FEMA inspectors stated that some expenditures involved ineligible work, namely, work completed on private property, and were not eligible for FEMA funding.

**Reference Number 2004-06**

Knott County Fiscal Court Paid For Culverts Provided By County And Installed On Private Property As Well As Paid For Excessive Hours To A Related Party Contractor

During our review of Federal Emergency Management Agency (FEMA) expenditures, we found that the Fiscal Court paid a relative of the County Judge/Executive \$11,168 for culverts the County supplied on private property. This constitutes a related party transaction. In addition, the FEMA inspector noted the contractor charged hours above the maximum amount allowed by federal regulations.

FEMA inspectors denied this expenditure on September 12, 2003, after an on-site inspection. A FEMA inspector noted the reason in two narratives related to Left Fork and Right Fork of Dry Creek where the inspector wrote, "It should be noted that adjustments were made to the contractor invoice in two areas: 1) the contractor charged for culverts furnished by the applicants; 2) the contractor charged for culverts not installed on public property; and 3) the contractor charged for equipment including operator for 24 hour periods – these were adjusted to 14 hours maximum. These adjustments were made based on information furnished by the applicant and field observation." The Fiscal Court paid for this work on February 11, 2004 and September 2, 2004 after the FEMA inspection.

Fiscal Court should not expend public funds for work on private property. The Fiscal Court should review invoices to ensure expenditures are reasonable, necessary, and for the appropriate amount. In addition, the Assistant Director of Emergency Management should have advised Fiscal Court of FEMA's disallowance. Office of Management and Budget (OMB) Circular A-87 Cost Principles For State, Local and Indian Tribal Governments determines a cost to be reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. A related party transaction is a business deal or arrangement between two parties who are joined by a special relationship prior to the deal.

This matter is being referred to the Office of Attorney General to determine whether further investigation is warranted as to a possible violation of KRS 522.030 - Official Misconduct in the Second Degree or other laws. Further, we recommend the County Attorney or Attorney General seek restitution from the private property owners and provide the Governor's Office for Local Development a written notification of resolution to this finding. Finally, Fiscal Court should provide adequate oversight and monitor financial activities to ensure work is completed in accordance with applicable laws and regulations.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

**STATE LAWS AND REGULATIONS (Continued)**

**Reference Number 2004-06 (Continued)**

Knott County Fiscal Court Paid For Culverts Provided By County And Installed On Private Property As Well As Paid For Excessive Hours To A Related Party Contractor

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*County Judge/Executive Donnie Newsome's Response:*

*The County Judge/Executive does not agree that culverts were installed for benefit of private property.*

Auditor's Reply:

Written notations by FEMA inspectors stated that some expenditures involved ineligible work, namely, work completed on private property, and were not eligible for FEMA funding.

**Reference Number 2004-07**

**An Altered Invoice Was Submitted To Knott County Fiscal Court And Subsequently Paid**

During our test of expenditures, we noted an invoice upon which the amount had whiteout covering the totals. The amount was changed to \$19,950. Upon review auditors could see the number "27" had been changed to "19" indicating a change from \$27,000 to \$19,000. The invoice was submitted to the Fiscal Court for approval on two different occasions. On November 19, 2003, the Fiscal Court approved the invoice in the amount of \$27,580 from the Jail Fund. According to the County Attorney, the invoice was approved for payment by the Fiscal Court on December 23, 2003 in the amount of \$19,950. On December 30, 2003, a check was written in the amount of \$19,950 to pay the contractor. This was the only expenditure made to this contractor from the Jail Fund during the fiscal year.

Due to the nature of the alteration and the inconsistencies noted in Fiscal Court approval, we cannot determine if this was a valid transaction. There is a question as to whether the invoice was altered to avoid the competitive bidding requirement for expenditures exceeding \$20,000.

Fiscal Court should require an invoice to be in its original state. Any changes to invoices should note the reason for the change, and proper approval should be obtained. If the Fiscal Court previously approved the claim, then the Fiscal Court should be notified of any subsequent change, and proper approval should be granted.

This matter is being referred to the Office of Attorney General to determine whether further investigation is warranted as to a possible violation of KRS 516.030 - Forgery in the Second Degree or other laws. We have asked the Knott County Attorney and Attorney General to investigate this matter. The Governor's Office for Local Development should be formally notified in writing of the resolution of this finding. Finally, Fiscal Court should provide adequate oversight and monitor financial activities to ensure payments are made in compliance with all applicable laws and regulations.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

**STATE LAWS AND REGULATIONS (Continued)**

**Reference Number 2004-07 (Continued)**

**An Altered Invoice Was Submitted To Knott County Fiscal Court And Subsequently Paid**

*County Judge/Executive Donnie Newsome's Response:*

*The invoice in question was reduced at the request of the Fiscal Court because they felt the price for the work was too high. We agree that the contractor should have prepared a new invoice, but we do not believe this was intended to deceive anyone.*

**Reference Number 2004-08**

**County Employees Used The County Judge/Executive's Credit Card**

Our examination of credit card statements show approximately \$1,500 of purchases that were made from the County Judge/Executive's credit card during the time of his incarceration. The County Judge/Executive was incarcerated from April 1, 2004 to February 15, 2005.

Strong internal controls dictate that no other employee should use a credit card assigned to another county official for any reason. Employees who have credit cards issued to them are responsible for the purchases made on that card. A strong internal control system dictates that there be procedures in place that reconcile monthly credit card receipts submitted by employees to the credit card statements.

The County allowed other employees the use of the County Judge/Executive's credit card in his absence. The County did not reconcile these credit card receipts to the credit card statements to ensure proper use of credit cards resulting in County employees charging approximately \$1,500 to the County Judge/Executive's credit card. Auditors determined there was proper supporting documentation for the transactions.

We recommend that the County Attorney or Attorney General review these transactions to determine whether restitution should be made. Also, the Fiscal Court should implement procedures to eliminate the use of credit cards by unauthorized users and to reconcile the credit card receipts to the credit card statements on a monthly basis.

*County Judge/Executive Donnie Newsome's Response:*

*Bank credit cards are no longer utilized.*

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

STATE LAWS AND REGULATIONS (Continued)

**Reference Number 2004-09**

The County Judge/Executive's Salary Was Overpaid By \$2,452

The County did not compensate the County Judge/Executive correctly. The Judge/Executive was paid \$66,205, representing an overpayment of \$2,452 from the statutory maximum salary allowed.

The Governor's Office for Local Development established a salary of \$63,753 for the Knott County Judge/Executive in the 2004 County Judge/Executive Maximum Salary Authorizations schedule, based on the requirements of KRS 64.527(5) and KRS 67.705(2), both of which address judge/executive compensation requirements.

The Judge/Executive was overpaid by \$2,452 for calendar year 2004.

We recommend the Judge/Executive pay the County \$2,452 for reimbursement of this overpayment. We recommend the County Attorney or Attorney General take appropriate steps to ensure the County is reimbursed these funds. Also, we recommend the County adhere to KRS 64.527(5) and KRS 67.705(2) in the future.

*County Judge/Executive Donnie Newsome's Response:*

*The County Judge/Executive disagrees. Cordell Lawrence, Director of Division of Financial Services, established the salary of the Judge/Executive for 2004 at \$64,952.94. Moreover, the auditors have included one too many payrolls in its 2004 computations.*

*Auditor's Reply:*

Auditors reconciled Form W-2 wages to individual annual earnings wage reports prepared by the County Treasurer. Earnings exceeded the salary maximum established by State Local Finance Officer Cordell Lawrence on correspondence dated February 5, 2004.

**Reference Number 2004-10**

The County Failed To Comply With The Governor's Office For Local Development Reporting Requirements And Kentucky Revised Statutes Related To Financial Reporting, Management, Investment And Protection Of County Funds

The county did not follow the guidelines set forth in the instructional guide and policy manual issued by the State Local Finance Officer and applicable Kentucky Revised Statutes. Specifically, the following non-compliances were noted:

- An annual financial statement was not presented to the fiscal court for approval within 30 days of fiscal year end.
- Fiscal Court did not execute a written agreement with depository institution to perfect the county's interest in the pledge of securities to protect deposits totaling \$1,217,345 on June 30, 2004. Of the year-end deposit totals, \$489,880 was related to federal funds.
- Fiscal Court did not review the administrative code.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

STATE LAWS AND REGULATIONS (Continued)

**Reference Number 2004-10 (Continued)**

The County Failed To Comply With The Governor's Office For Local Development Reporting Requirements And Kentucky Revised Statutes Related To Financial Reporting, Management, Investment And Protection Of County Funds

- Fiscal Court does not have a written investment policy.
- Fiscal Court did not pay invoices within 30 days as required. Twenty (20) instances were noted in which payment to vendors occurred more than 30 days after the county received the invoice(s). Three of the instances involved invoices related to federal expenditures. In addition, the statutory 1% interest penalty was not paid to vendors for each month payments exceeded 30 days. Approximately 1/3 of the invoices in the test sample were not paid within the statutory time frame. In one instance, the county did not pay an invoice until six months after they received it.
- Fiscal Court did not pay invoices in full. Partial payments in the amount of \$127,000 relating to federal expenditures were made for four invoices totaling \$250,008. The remaining \$123,008 was paid during fiscal year 2005.
- Fiscal Court has not adopted small purchase procedures as required.
- The finance officer did not maintain a timesheet.

KRS 68.020(5) outlines provisions for settlement of the treasurer's accounts within 30 days after the close of each fiscal year. A written security agreement is a requirement of 12 U.S.C. § 1823(e). KRS 68.005(2) states, "The fiscal court shall review the county administrative code annually and during the month of June and may by a two-thirds majority of the entire fiscal court amend the county administrative code at that time." Requirements for a written investment policy are addressed in KRS 66.480(3). Compliance requirements regarding expenditures are noted in KRS 65.140(2), which requires all bills for goods and services to be paid in full within 30 working days of receiving vendor invoices. It continues to state that if payment of invoices exceeds thirty days, a 1% interest penalty should be added. Also, the county's administrative code states the fiscal court adopted KRS Chapter 45A, *Model Procurement Code*, in its entirety. KRS Chapter 45A.385 allows purchases without bidding for contracts less than the \$20,000 threshold if the small purchase procedures are in writing and available to the public. KRS 337.320 requires that employers keep a record of the hours worked each day and week by each employee. Timesheets are also necessary to document eligibility for employee benefits such as retirement.

We recommend the county review, utilize and adhere to all applicable laws and regulations. Specifically, we recommend the county take the following action to comply with the Governor's Office for Local Development requirements and Kentucky Revised Statutes included within:

- Present an annual financial statement to the fiscal court for approval within 30 days.
- Execute a written agreement with depository institution to protect deposits.
- Review administrative code annually in June.
- Adopt a written investment policy.
- Ensure expenditures occur within 30 days of receiving vendor invoices or compensate vendors according to statutory interest penalties for payments exceeding 30 days.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

**STATE LAWS AND REGULATIONS (Continued)**

**Reference Number 2004-10 (Continued)**

The County Failed To Comply With The Governor's Office For Local Development Reporting Requirements And Kentucky Revised Statutes Related To Financial Reporting, Management, Investment And Protection Of County Funds

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- Eliminate the practice of partial payments on invoices and pay all invoices in full when received.
- Draft and adopt small purchasing procedures in accordance with the administrative code and KRS Chapter 45A, *Model Procurement Code*.
- Maintain timesheets for all employees.

*County Judge/Executive Donnie Newsome's Response:*

*County disagrees with the contention that it failed to present the annual financial statement to the fiscal court within 30 days, but acknowledges that it was late with regard to the 60 day publishing requirement. County will strive to meet this deadline.*

*The current Treasurer will execute a written agreement with depository institution (Community Trust Bank) to protect deposits.*

*County will review administrative code.*

*County now has a written investment policy.*

*In the cited instances, the vendors were agreeable to the delays.*

*These invoices were paid as FEMA money received.*

*County will draft small purchasing procedures for consideration and adoption of Fiscal Court.*

*County will maintain time sheets for all applicable employees. However, pursuant to KRS 337.010 (2)(a), the finance officer is not an employee for whom a timecard is to be kept.*

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

STATE LAWS AND REGULATIONS (Continued)

**Reference Number 2004-11**

The Jailer Did Not Comply With State Laws Regarding Jail Canteen Operations

Although Knott County does not operate a full service jail and does not operate a canteen, activity was noted in the jail canteen bank account suggesting that jail canteen activity did occur during FY 2004. The jail provides temporary housing for inmates until other housing arrangements can be made. During the course of jail canteen audit procedures, we noted the following issues regarding canteen activity:

- The Jailer did not submit an annual canteen report to treasurer as required by law.
- The Jailer did not maintain proper supporting documentation for expenditures. No invoices were available for two canteen transactions, totaling \$160.
- No documentation was provided to determine if profits from the canteen were expended for the benefit or recreation of the inmates as required by law.

KRS 441.135 establishes the authority for a jailer to operate a jail canteen. The statute requires all profits from canteen operations be used for the benefit or recreation of the inmates. Additionally, KRS 441.135(2) requires the Jailer to submit an annual report to the Treasurer regarding canteen activity.

Without proper supporting documentation, the appropriateness of canteen expenditures and compliance with KRS 441.135 cannot be determined.

We recommend the Jailer implement the following procedures to improve accounting and reporting practices for jail canteen activity:

- The Jailer should submit an annual report to the Treasurer for all canteen activity during the period.
- The Jailer should maintain proper supporting documentation for canteen transactions including, but not limited to, invoices, purchase orders, packing lists, deposit tickets, and receipt and disbursement ledgers.
- All profit expenditures from the canteen should be used for the benefit or recreation of the inmates and documentation supporting such transactions should be maintained.

*County Judge/Executive Donnie Newsome's Response:*

*Jailer no long handles any proceeds and is no long in charge of any canteen funds. Knott County prisoners are now housed at a regional facility in Perry County.*

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

REPORTABLE CONDITIONS:

**Reference Number 2004-12**

Knott County Fiscal Court Should Improve Internal Controls Over County Vehicles

Numerous county vehicles are maintained by the County and assigned to employees for business use. County employees and officials have access to these vehicles during non-business hours. Audit staff was informed that many employees drive the County vehicles to and from work and for personal business. The County pays for insurance coverage, annual taxes, repairs/maintenance, and fuel for these county vehicles. The following is a partial list of county vehicles and the employee/department responsible for each vehicle as of June 30, 2004:

Year	Make	Model	VIN	Title/Department
2003	Jeep	Cherokee	1J4GW58N63C556109	Judge/Executive
1999	Chevy	4x4	1GCGK24R2XR719544	Magistrate
1999	Chevy	4x4	1GCGK24R3XR719603	Magistrate
1999	Chevy	4x4	1GCGK24R5XR708117	Magistrate
1999	Chevy	4x4	1GCGK24R7XR706112	Magistrate
2002	Chevy	Tahoe	1GNEK13Z32J307344	Treasurer
1999	Jeep	Cherokee	1J4GW58NOXC753735	Finance Officer
1996	Chevy	Caprice	1G1BL52P9TR124574	County Finance Director
2001	Jeep	Cherokee	1J4FF48S71L502696	Bookkeeper - Sheriff
1998	Ford	Expedition	1FMRU18W6WLB34170	Bookkeeper - Sheriff
1991	Jeep	Cherokee	1J4FJ28S5ML57798	Emergency Management Asst. Director
1994	Ford	Explorer	1FMDU34X8RUEO7127	Emergency Management Director
2003	Chevy	Tracker	2CNBJI3C236945993	E-911
1993	Jeep	Cherokee	1J4FJ27S8PL520198	Parks
1992	Jeep	Cherokee	1J4FT28SXNL155416	Parks
1990	Dodge	Ram	3B7GE13Y3LMO13950	Animal Control
1993	Jeep	Cherokee	1J4FJ27S4PL520201	Works Program
2003	Toyota	Tacoma	5TEWM72N33Z262065	Ecology/Solid Waste
2000	Jeep	Cherokee	1J4FF28SOYL257755	Human Services Director
1994	Toyota	4Runner	JT2VN39W3R8060714	Human Services
2001	Chrysler	Van	1C4GJ25B71B216340	Human Services
2002	Chevy	Van	1GNDU23E42D272823	Human Services
1994	Ford	Crown Victoria	2FALP71WXVX183653	Human Services
1994	Toyota	Pickup	4TARNO1P1RZ193770	Human Services
1999	Chevy	Truck (4 DR)	1GCGK24R7XR714923	Road Foreman
1999	Chevy	Truck (4 DR)	1GCGK24ROXR714830	Bridge Foreman



**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

REPORTABLE CONDITIONS: (Continued)

**Reference Number 2004-12 (Continued)**

Knott County Fiscal Court Should Improve Internal Controls Over County Vehicles

The county has implemented controls over vehicle use based on previous audit suggestions; however, the controls implemented have not addressed the core issues regarding personal use of public vehicles. The following issues warrant further consideration by the Fiscal Court and need to be addressed:

- Mileage logs do not contain information sufficient to distinguish personal use from business use. In the mileage logs tested, vital information was not included, such as the actual mileage for each trip listed.
- Commuting use of vehicles is not properly included on employees' Form W-2 statements for tax liability.
- The necessity of County vehicles for employees other than those who are on call at all times is in question, especially in relation to commuting use that has been permitted by the Fiscal Court. The cost of these vehicles for maintenance and insurance significantly increases cost to taxpayers.

The County's Administrative Code states, in Section 820.2; "no official or employee shall request, use or permit the use of any publicly-owned or publicly-supported property, vehicle, equipment, material or service for the personal convenience or the private advantage of himself or any other person unless such use has been formally authorized." In addition, the County's vehicle use policy restricts the use of County vehicles to Fiscal Court business only. The vehicle use policy states further that all out of county trips must be logged, and that any vehicle driven home by an employee is expected to be parked by 6:00 pm unless Fiscal Court business requires otherwise.

Personal use of public resources is permitted if the entity has approved such use; however, personal use should be reported as compensation on employees' wage and tax statements. Internal Revenue Code Section 61(a) states that the commuting value of a vehicle owned or leased by a public entity represents taxable income to the employee.

Controls over vehicles do not address issues related to personal use of vehicles. Consequently, the personal use of public vehicles allows employees to receive an employee benefit without incurring the appropriate tax consequences of such benefits. The County's vehicle use policy allows the employees to drive the County vehicles home, but the County does not currently include any of the commuting use of public resources on wage and tax statements. The vehicle use policy approved by the Fiscal Court requires that only out of county trips be logged by officials/employees. Documentation of in-county mileage is not required. This increases the risk that employees are using vehicles for personal reasons because employees are not required to account for every mile that is traveled with public vehicles.

We recommend the County improve controls over County vehicles by implementing the following:

- The Fiscal Court should contact the Kentucky Department of Revenue and the Internal Revenue Service relating to wage reporting and tax liability in prior years and enforce current policy related to vehicles assigned.
- Every employee and every department that has county vehicles should maintain vehicle logs. The logs should include, at a minimum, the date, destination, purpose, and mileage for ALL use of the vehicle.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

REPORTABLE CONDITIONS: (Continued)

**Reference Number 2004-12 (Continued)**

Knott County Fiscal Court Should Improve Internal Controls Over County Vehicles

- Personal use and commuting mileage for County vehicles should be properly reported as compensation/employee benefit on W-2s in accordance with IRS regulations. Several methods can be used to determine the vehicle use that is taxable income to the employees, including the cents-per-mile rule, the lease value rule, and the commuting rule.
- The County should evaluate the necessity of County vehicles for each employee. Vehicles should be assigned based on criteria established by the Fiscal Court and not for the convenience of the official/employee. In addition, the County should explore alternatives for County related travel, including the possibility of compensating employees based on a mileage reimbursement rate when their personal vehicle is used for business travel instead of providing a county vehicle for the business travel.

*County Judge/Executive Donnie Newsome's Response:*

*The Fiscal Court will be asked by me to comply with this audit recommendation.*

**Reference Number 2004-13**

Approximately \$7.8 Million Of Assets Are At Risk Due To Inadequate Insurance Coverage

As of the date of this audit report, the Knott County Judicial Center, Detention Center, and the ongoing swimming pool project do not have adequate flood insurance. According to the former County Finance Officer, the county sought flood insurance on the \$5.7 million Judicial Center after Federal Emergency Management Agency (FEMA) denied benefits from a June 14, 2003 flood where materials to be used for the construction of this building were damaged. The former Finance Officer informed audit staff the County obtained \$135,000 of flood insurance for this building but could not afford additional coverage. The outstanding principal debt balance at June 30, 2004 was \$6.37 million on the Judicial Center.

The \$1.1 million Detention Center and the swimming pool project with costs exceeding \$1 million do not have any flood insurance. The county does have a \$1 million flood policy through KACo; however, this policy does not cover buildings located in the 100-year floodplain. The Judicial Center, Detention Center, and swimming pool project are all located in the 100-year floodplain.

Good cash management dictates the Fiscal Court retain adequate insurance coverage and ensure assets of significant value are included on insurance policies. According to FEMA's *Public Assistance Guide* for insurable structures that do not have flood insurance or carry inadequate flood insurance, FEMA will reduce all grants by the greater of: 1) the maximum amount of insurance proceeds that could have been obtained from a standard National Flood Insurance Program flood insurance policy; or 2) the actual insurance proceeds received.

Approximately \$7.8 million of the county's assets, representing about 96% of buildings, are at risk because the Fiscal Court does not maintain adequate flood insurance. In addition, the assets that are not adequately insured were all recently constructed or remodeled.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

REPORTABLE CONDITIONS: (Continued)

**Reference Number 2004-13 (Continued)**

Approximately \$7.8 Million Of Assets Are At Risk Due To Inadequate Insurance Coverage

In addition, our testing noted that a 2002 Chevy Tahoe purchased during the fiscal year for \$39,166 failed to be added to the county's insurance policy.

We recommend the Fiscal Court maintain adequate insurance coverage for all assets. Officials should periodically review insurance policies to ensure all assets have been added or deleted as necessary. Also, we recommend the Fiscal Court obtain flood insurance for all assets located in flood prone areas in an amount sufficient to recover losses suffered in the event of a flood.

*County Judge/Executive Donnie Newsome's Response:*

*The County's insurance agent advised that the 2002 Chevy Tahoe has always been on the County's insurance policy. It is my understanding that flood insurance is either unattainable or cost prohibitive on structures located in the 100 year flood plain. However, it is also my understanding that the judicial center, detention center and pool/youth center projects are built up out of the 100 year flood plain.*

**Reference Number 2004-14**

Knott County Fiscal Court Paid A Significant Portion Of County Funds To A Single Contractor

During fiscal year 2004, the county paid \$1,316,651 to companies owned by one contractor and his immediate family. This accounts for approximately 21% of all county expenditures net of payroll, debt service and pass-through grants, which totaled \$6,254,682. Auditors tested \$648,282 of transactions related to this contractor. The following was discovered:

- Seven transactions totaling \$355,717 did not have original supporting documentation. Of these, four involved federal expenditures totaling \$265,997.
- Four transactions totaling \$249,997 were executed without proper bidding requirements. Of these, \$219,997 were federal expenditures.

It appears the county has executed numerous contracts and transactions with a single contractor without adhering to competitive bidding requirements, thus limiting competition for county contracts. In addition, proper documentation was not maintained for numerous transactions related to the contractor.

We recommend the county adhere to all applicable laws and regulations regarding competitive bidding requirements and maintain original documentation for all expenditures. Furthermore, we recommend the County Attorney or Attorney General review all transactions related to the contractor for propriety and appropriateness.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

REPORTABLE CONDITIONS: (Continued)

**Reference Number 2004-14 (Continued)**

Knott County Fiscal Court Paid A Significant Portion Of County Funds To A Single Contractor

*County Judge/Executive Donnie Newsome's Response:*

*County will attempt to always get original invoices. County needs more information from the auditors to respond to the assertion that proper bidding requirements were not followed in "four transactions totaling \$249,997". In general, though, County followed proper bidding requirements.*

**Reference Number 2004-15**

Knott County Fiscal Court Financial Management, Expenditure Documentation, And Payment Procedures Are Inadequate

During the course of our engagement, we noted the County did not implement proper accounting and internal control procedures for financial management activities:

- Inadequate or missing supporting documentation
  - Auditors noted 10 expenditures out of 60 tested that did not have adequate supporting documentation. In seven instances, faxed copies of invoices, totaling \$184,467 (of which \$59,442 were invoices paid with federal funds), were provided to auditors instead of original invoices/documentation. In three instances totaling \$101,529, copies of invoices were provided instead of original documentation. Since we did not have original documents we could not attest to the legitimacy of all items tested.
  - The County did not maintain proper documentation for two new leases executed during the audit period. Lease agreements and amortization schedules had to be obtained from third parties (financial institution and financial advisor) for an ambulance lease and an E-911 pager project lease. In addition, the ambulance lease was not included in the Liabilities & Leases section of the 4<sup>th</sup> Quarter Financial Report.
- Lack of proper accounting practices
  - Bank reconciliations were not prepared for the Knott County 911 Emergency Services bank account for the entire audit period.
  - Counter checks were used for several bank accounts. Examples include the Youth Development Center account and the 2001 Flood account. The 2001 Flood account contains federal funds related to Federal Emergency Management Agency. In addition, counter checks were not maintained in a secure location.
  - Imaged copies of the backs of checks were not maintained with bank statements including those statements for accounts containing federal funds.
  - Fiscal Court did not approve expenditures in the prescribed manner. In fact, the Fiscal Court did not approve 9 of the 60 expenditure transactions tested. The total dollar value of the unapproved transactions was \$225,496. Of the unapproved transactions, two involved federal expenditures totaling \$91,810.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

REPORTABLE CONDITIONS: (Continued)

**Reference Number 2004-15 (Continued)**

Knott County Fiscal Court Financial Management, Expenditure Documentation, And Payment Procedures Are Inadequate

- Invoices were not properly cancelled upon payment to prevent duplicate payments in two instances, one of which was an invoice paid with federal grant monies in the amount of \$14,632.
- Purchase orders were not issued in accordance with established guidelines. Important information was often excluded from purchase orders such as product descriptions, quantities, prices, totals, and appropriation codes. Also, purchase orders were processed without proper approval signatures.

Good internal controls dictate that adequate supporting documentation be maintained for all receipts and disbursements. The Governor's Office for Local Development (GOLD) requires that original documentation be maintained for all expenditures. Copies of invoices and faxed invoices are unacceptable. All original invoices should agree to corresponding purchase orders. Additionally, all documentation for financing activity should be maintained and included on financial reports.

Proper accounting procedures and internal control policies should be in place. Bank reconciliations should be prepared for all accounts. Pre-numbered and preprinted checks should be used for disbursements. The use of counter checks should be limited. All checks should be stored in a secure location. Bank statements with imaged copies of both front and backsides of checks should be maintained. All expenditures should be reviewed and approved by the Fiscal Court prior to payment. Also, disbursements should be made as soon as practical after the Fiscal Court approves the expenditures. All invoices should be cancelled upon payment. Purchasing procedures should be in accordance with GOLD requirements, specifically, purchase orders must include the appropriation account number to which the claim will be posted and proper approval by management or the department head. Vendor names, departments, product descriptions, quantities, and prices should be on each purchase order issued in order for the purchasing procedures to be effective. Sound management and a good internal control structure are essential for the achievement of full oversight and accountability.

Lack of proper accounting practices and internal controls increases the risk that misstatements of financial activity and/or fraud will occur and go undetected by the County. Without proper procedures in place to mitigate this risk, the County is exposing public resources to potential misstatements and/or fraud.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

REPORTABLE CONDITIONS: (Continued)

**Reference Number 2004-15 (Continued)**

Knott County Fiscal Court Financial Management, Expenditure Documentation, And Payment Procedures Are Inadequate

We recommend the County take critical steps to implement proper accounting and internal control procedures and monitor financial management activities by doing the following:

- Develop procedures for retaining adequate supporting documentation for all financial transactions.
  - Maintain original invoices for all expenditures.
  - Maintain proper documentation for all financing activities including, but not limited to, lease agreements and amortization schedules. Also, all financing activity should be included on financial reports as required.
- Develop procedures to ensure good accounting practices and internal control procedures.
  - Complete reconciliations for all bank accounts within 30 days after the statement dates. Agree reconciliations to the general ledger. Investigate and resolve discrepancies immediately. Attach a list of outstanding checks and deposits in transit.
  - Limit the use of counter checks and keep all checks in a secure location.
  - Maintain bank statements with imaged copies of both front and backsides of checks.
  - Approve and review all disbursements prior to payment. In addition, the lapse of time between approval of expenditures and the actual disbursement should be limited.
  - Cancel (mark paid) all invoices upon payment.
  - Adhere to purchasing procedure requirements and guidelines.

*County Judge/Executive Donnie Newsome's Response:*

*On some occasions a facsimile is the only invoice the County receives. Nevertheless, County will strive to obtain "original" invoices.*

*County is now in compliance with recommendation regarding maintenance of records of financing activities.*

*County does complete reconciliations for bank accounts. The account in question was a small account not utilized for some time and the statements came to the 911 Coordinator rather than the Treasurer. This has now been resolved so that the Treasurer receives this statement.*

*Counter checks were used in instances where only a few checks would be necessary so as avoid ordering unnecessary checks.*

*Our financial institution does not, and advised that they will not, provide images of the backs of checks in the monthly bank statements.*

*County will approve and review all disbursements prior to payment.*

*County will cancel (mark paid) all invoices upon payments.*

*County will adhere to purchasing procedures requirements and guidelines.*

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

REPORTABLE CONDITIONS: (Continued)

**Reference Number 2004-16**

The County Does Not Maintain Proper Documentation For Capital Assets

The County does not maintain original documentation for all capital assets. Several instances were noted in which copies had to be obtained for deeds, titles and invoices since the original documentation could not be located. Additionally, some deeds, titles, and invoices were not available at all.

The County cannot properly determine insurance needs or if surplus property is owned without proper documentation. The *Instructional Guide For County Budget Preparation and State Local Officer Policy Manual*, issued by the Governor's Office for Local Development (GOLD), outlines requirements for capital assets. The requirements specifically state: "All contracts, invoices, purchase orders & authorizations, vendor bidding documentation, receipts, deeds, etc. must be maintained/filed with the asset documentation records."

The County does not maintain proper supporting documentation for capital assets and did not comply with capital asset requirements as established by GOLD.

We recommend the County maintain all capital asset documentation as required in GOLD's policy manual. Original documentation should be maintained in a central location with copies provided to the applicable departments as necessary for departmental recordkeeping.

*County Judge/Executive Donnie Newsome's Response:*

*County intends to comply with this recommendation.*

**Reference Number 2004-17**

Fiscal Court Should Improve Policies and Procedures Related To The Schedule Of Expenditures Of Federal Awards

During our review of the Schedule of Expenditures of Federal Awards (SEFA), we noted multiple significant errors. Specifically, we noted the following errors:

- Approximately \$474,837 of federal expenditures were not included on the schedule.
- The SEFA did not include all applicable federal grants awarded to the County government.
- The expenditures listed on the SEFA were the total amount paid to contractors and not the federal portion only of the expenditures.
- The County did not include force labor, equipment or materials used by the county on the SEFA for the Federal Emergency Management Agency grant.

In addition to these errors, the SEFA was not prepared in a timely manner for audit.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**B. FINDINGS – FINANCIAL STATEMENT AUDIT (Continued)**

REPORTABLE CONDITIONS: (Continued)

**Reference Number 2004-17 (Continued)**

Fiscal Court Should Improve Policies and Procedures Related To The Schedule Of Expenditures Of Federal Awards

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OMB Circular A-133, Subpart C—Auditees; §\_\_\_\_.300 Auditee responsibilities states, “The auditee shall:

- Identify, in its accounts, all Federal awards received and expended and the Federal programs under which they were received. Federal program and award identification shall include, as applicable, the CFDA title and number, award number and year, name of the Federal agency, and name of the pass-through entity.
- Prepare appropriate financial statements, including the schedule of expenditures of Federal awards in accordance with §\_\_\_\_.310.”

The effect of these errors on the FY 04 SEFA, together with the control environment of this entity, has led the auditors to question whether all federal grant awards and expenditures were included on the SEFA.

We recommend Fiscal Court follow OMB Circular A-133 for preparation of the government’s SEFA and review for completeness. We further recommend procedures be put into place to ensure all federal grants awarded and expenditures paid are included.

*County Judge/Executive Donnie Newsome’s Response:*

*County intends to comply with this recommendation.*



**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARDS PROGRAM AUDIT**

**Reference Number 2004-18**

Knott County Fiscal Court Has Questioned Costs Of \$893,300 Of Federal Emergency Management Agency Funds Due To Failure To Comply With Federal A-102 Common Rule Requirements

Federal Programs: All

Federal Agency: All

Compliance Area: All

Amount of Questioned Costs: \$893,300

Based upon our review of Knott County Fiscal Court records, all Federal Emergency Management Agency (FEMA) grant fund expenditures totaling \$893,300 should be questioned. This report reflects possible violations of statutory, contractual and administrative regulations, and the other comments should be read in conjunction with this comment. Although FEMA was the only major federal program tested, results from these tests led to concerns of the grant management over all federal funds administered by the Fiscal Court. Specifically we noted instances of:

- Possible criminal violations of Kentucky Revised Statutes.
- Noncompliance with federal grant agreements pursuant to Office of Management and Budget governing regulations.
- Noncompliance with the Governor's Office for Local Development's administrative regulations and the County Administrative Code.
- Failure to adequately prepare the required Schedule of Expenditures of Federal Awards (SEFA).
- Competitive bidding was not obtained as required by County Ordinance and the Kentucky Model Procurement Code.
- Duplicate payments made to contractors, work completed on private property, and lack of supporting documentation.
- Possible ethics violations as defined by the County Administrative Code with related parties.

These instances, in the aggregate, increase the opportunity and ability to commit fraud. Therefore, we assess fraud risk to be high.

Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments (also known as the "A-102 Common Rule"), section 13.20, requires the County, as a recipient of federal funds, to comply with all applicable laws and procedures. In addition, the Fiscal Court should ensure that fiscal controls and accounting procedures are sufficient to prepare accurate, current, and complete reports. In addition, the A-102 Common Rule states that internal controls should be effective to adequately safeguard assets, and that Office of Management and Budget Circular A-87, Cost Principles For State, Local and Indian Tribal Governments, should be followed to determine reasonableness and allowability of costs. Finally, the Common Rule requires accounting records to be supported by sufficient documentation.

Based upon the cumulative comments included in this report we have questioned costs, paid for with FEMA funds, of \$491,783 in fiscal year 2004, as well as \$401,517 in fiscal years ended June 30, 2001, 2002, and 2003.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARDS PROGRAM AUDIT**  
**(Continued)**

**Reference Number 2004-18 (Continued)**

Knott County Fiscal Court Has Questioned Costs Of \$893,300 Of Federal Emergency Management Agency Funds Due To Failure To Comply With Federal A-102 Common Rule Requirements

We recommend that FEMA complete a thorough review of all FEMA expenditures for this audit period, and also for fiscal years ended June 30, 2001, 2002 and 2003. Since this finding may impact other federal programs not covered under the audit work performed we further recommend any federal granting agencies review those grants awarded to the Fiscal Court.

*County Judge/Executive Donnie Newsome's Response:*

*The County disagrees that FEMA funds were paid in any improper fashion. In each questioned incident during the years noted, County personnel were following FEMA personnel instructions. The County denies any fraud risk in regard to any of these projects, and welcomes any review FEMA may wish to undertake.*

**Reference Number 2004-19**

Knott County Fiscal Court Made A Duplicate Payment To A Contractor In The Amount Of \$19,760 For Federal Emergency Management Agency Work

Federal Program: CFDA #97.036 Disaster and Emergency Assistance Grant

Federal Agency: Homeland Security

Compliance Area: Allowable Costs

Amount of Question Costs: \$19,760

During our testing of Federal Emergency Management Agency (FEMA) expenditures, auditors found that a contractor was overpaid in the amount of \$19,760. The former County Treasurer received a faxed invoice dated August 21, 2003, for work performed on Beaver Creek Park. The Fiscal Court approved these expenditures on November 19, 2003, and paid the contractor on February 2, 2004. A second invoice received reflected the contractor was paid for the same work on February 11, 2004.

Good internal controls dictate that procedures be implemented to prevent duplicate payments, and that expenditures be paid only from original documentation.

We recommend the County Attorney or Attorney General seek restitution from the contractor in the amount of \$19,760, and notify the Governor's Office for Local Development, in writing, of the resolution of this finding. In addition, we recommend that the County Treasurer accept only original invoices for documentation for payment, and implement procedures to prevent duplicate payments from occurring.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARDS PROGRAM AUDIT**  
**(Continued)**

**Reference Number 2004-19 (Continued)**

Knott County Fiscal Court Made A Duplicate Payment To A Contractor In The Amount Of \$19,760 For  
Federal Emergency Management Agency Work

*County Judge/Executive Donnie Newsome's Response:*

*The County Judge/Executive, after consultation with the former Treasurer and Financial Director, disagrees that a duplicate payment of \$19,760 was made. In addition, project invoices were submitted to Fiscal Court for payment approval, then passed to County Treasurer for payment only if approved by the Fiscal Court. Nevertheless, the County Judge/Executive has asked the County Attorney to review this alleged overpayment.*

Auditor's Reply:

The Fiscal Court's own records bear out the findings of the audits. It is clear that a duplicate payment occurred.

**Reference Number 2004-20**

Knott County Fiscal Court Did Not Earmark \$46,576 Of Federal Receipts Or Provide \$10,787 In  
Matching Funds For Federal Expenditures

Federal Program: CFDA #97.036 Disaster and Emergency Assistance Grant

Federal Agency: Homeland Security

Compliance Area: Matching, Level of Effort, Earmarking

Amount of Question Costs: None

During our testing we analyzed the Federal Emergency Management Agency (FEMA) bank account utilized by the Fiscal Court to account for FEMA receipts and contracted FEMA work. Funds contributed to this account include both advancement and reimbursement type receipts. Our analysis indicated the following:

- Knott County Fiscal Court did not match \$10,787 of FEMA funds expended. When the Fiscal Court receives FEMA funds from the state, the state provides 75% of federal and 12% of state contributions from FEMA. The Fiscal Court is obligated to match 13% of the approved FEMA projects. Examination of this bank account shows that only the federal and state portions of funds were deposited into this account. There is no indication the county has contributed the required matching funds. We did find the County matched \$64,432 as evidenced by work completed by county employees and paid from the Road Fund.
- Knott County Fiscal Court did not restrict \$46,576 of advanced FEMA payments. Advancements are paid by the state as soon as possible after FEMA obligates these funds and this usually provides for immediate needs after a disaster. Our analysis indicated that the advanced payments were used for projects other than the intended use.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARDS PROGRAM AUDIT**  
**(Continued)**

**Reference Number 2004-20 (Continued)**

Knott County Fiscal Court Did Not Earmark \$46,576 Of Federal Receipts Or Provide \$10,787 In Matching Funds For Federal Expenditures

The criteria for these findings are:

The grant agreement states that the applicant shall be responsible for 13% of all eligible costs.

Advance payments from FEMA are required to be restricted for the intended project. 44 CFR 13.20(2) states records should be maintained which adequately identify the source and application of funds. These records must contain information pertinent to grant awards and authorizations, obligations, unobligated balances, and assets.

We recommend the Fiscal Court immediately comply with the grant agreement and appropriately contribute \$10,787 of funds to meet matching requirements. The Fiscal Court should contribute \$46,575 of additional funds for projects FEMA paid in advance. In addition, the Fiscal Court should maintain records, which properly identify the source and application of funds. Records should contain information pertinent to grant awards including obligations, unobligated balance and assets.

*County Judge/Executive Donnie Newsome's Response:*

*County does not agree that this is correct. If after review it is determined that the auditor's statement is correct, then County intends to comply with the recommendations.*

**Reference Number 2004-21**

The Knott County Fiscal Court Did Not Maintain Proper Supporting Documentation For Federal Funds Resulting In Questioned Costs of \$415,767 For The July 2001 Disaster

Federal Program: CFDA #97.036 Disaster and Emergency Assistance Grant

Federal Agency: Homeland Security

Compliance Area: Allowable Costs and Reporting

Amount of Questioned Costs: \$415,767

The Knott County Fiscal Court did not maintain documentation to support the federal emergency disaster closeout form (P-4) for the flood occurring on July 27, 2001, noted as federal disaster #1388. The Federal Emergency Management Agency (FEMA) declared 34 roads as small project disaster areas in Knott County. Documentation indicates that all work performed to repair these 34 small projects was completed by the end of fiscal year 2004. Our test of the federal closeout disaster revealed that the county did not maintain supporting documentation for any of the 34 small projects. Therefore, we were unable to determine if these FEMA expenditures were appropriate. This was the only disaster closed out during fiscal year 2004.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

**FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARDS PROGRAM AUDIT**  
**(Continued)**

**Reference Number 2004-21 (Continued)**

The Knott County Fiscal Court Did Not Maintain Proper Supporting Documentation For Federal Funds Resulting In Questioned Costs of \$415,767 For The July 2001 Disaster

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According to the FEMA Policy Handbook, a grant recipient is required to establish and maintain accurate records of events and expenditures related to disaster recovery work. FEMA also requires the grant recipient have a financial and record keeping system in place that can be used to track transactions. Also, all of the documentation pertaining to a project should be filed with the corresponding project worksheet and maintained by the applicant as the permanent record of the project. These records become the verification of the accuracy of project cost estimates during validation of small projects, reconciliation of costs for large projects, and audits.

As a result of Knott County's failure to maintain documentation pertaining to the closeout of federal disaster #1388, we have questioned the entire amount expended in fiscal year 2004, which was \$14,250. Fiscal years 2001-2003 were not subject to A-133 audit requirements and were not tested. Therefore, we feel it necessary to question the \$401,517 expenditures from the prior years because supporting documentation could not be found in the closeout documentation.

We recommend that the county implement procedures established in the FEMA Policy Handbook by maintaining, "accurate disbursement and accounting records to document the work performed and the costs incurred." In addition, we recommend that FEMA complete a thorough review of disaster #1388 to determine if the expenditures were appropriate and in compliance with applicable FEMA requirements.

*County Judge/Executive Donnie Newsome's Response:*

*The County Judge/Executive adamantly maintains that proper FEMA directed documentation was kept for all disasters. The former disaster coordinator left employment days after the July 27, 2001 flood and information was reconstructed with the help of State emergency management personnel.*

**Auditor's Reply:**

Auditors requested FEMA documentation on April 18, 2005 and June 24, 2005. Auditors found that the documentation provided was incomplete and insufficient for all projects related to the closeout of Disaster #1388 based on FEMA documentation requirements.

**KNOTT COUNTY**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2004**  
**(Continued)**

PRIOR YEAR FINDINGS FINANCIAL STATEMENT AUDIT

- The Fiscal Court Should Maintain Correct Records
- Expenditures Are Not Being Paid Within 30 Days
- County Employees Should Comply With The County's Administrative Code
- The County Needs To Form An Ethics Commission In Accordance With The Code Of Ethics
- The County Should Have A Written Agreement To Protect Deposits
- The County Treasurer Should Prepare A Schedule Of Expenditures Of Federal Awards
- Internal Controls Over Credit Card Transactions Need To Be Implemented
- Internal Controls Over Vehicles Use Need To Be Implemented
- The County Had Material Related Party Transactions

The County now has a written agreement to protect its deposits. All other comments remain uncorrected and have been repeated in some form in the current report.

**KNOTT COUNTY**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**





FEDERAL MONIES WORKSHEET								
1	2	3	4	5	6	7	8	9
Name of Federal Agency or Department	CFDA Number	Name of Program	Name of Grant	Grant I.D. No.	Award Amount Received	Total Award Amounts Received Per CFDA Number	Award Amount Expended	Awards Expended Per CFDA Number
U.S. Dept. of Housing - Urban Development	14-228	CDCC	Kent Co. Head Start Center	01-049	306,900.00	330,000.00		
EDA	04-19-53016	Economic Development	Translucence Creek Flood Mitigation Project	04-19-53016	142,638.00	1,000,000.00		
U.S. Dept. of Housing - Urban Development	14-XXX	Disaster Recovery Initiative (DRI)	Kent Co. Head Start Project	98-096	72,385.14			

Date: 3-18-05

[illegible]

County Judge's Initials: DN  
County Treasurer's Initials: DC  
Date: 3-18-05

1	2	3	4	5	6	7	8	9
Name of Federal Agency or Department	CFDA Number	Name of Program	Name of Grant	Grant I.D. No.	Award Amount Received	Total Award Amounts Received Per CFDA Number	Award Amount Expended	Total Awards Expended Per CFDA Number
<div style="display: flex; justify-content: space-between;"> <div> <p>Total Financial Awards, All Programs (A through J)</p> </div> <div> <p>Sub Total Per CFDA Number</p> </div> </div>								
						1,586,071.53		

QUESTIONS & COMMENTS

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County Judge's Signature:

County Treasurer's Signature:

Date:

*Donnie Deane*  
*Debra C. Moore*

**KNOTT COUNTY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**Fiscal Year Ended June 30, 2004**

Note 1 - The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of Knott County, Kentucky and is presented on a cash basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations.

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON  
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL  
STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**





**CRIT LUALLEN**  
**AUDITOR OF PUBLIC ACCOUNTS**

The Honorable Donnie Newsome, Former Knott County Judge/Executive  
Members of the Knott County Fiscal Court

Report On Internal Control Over Financial Reporting And On  
Compliance And Other Matters Based On An Audit Of Financial  
Statements Performed In Accordance With Government Auditing Standards

We were engaged to audit the financial activity of the Fourth Quarterly Report of Knott County, Kentucky, as of and for the year ended June 30, 2004, and have issued our report thereon dated September 27, 2005. We did not express an opinion on the Fourth Quarterly Report because based on our assessment of fraud risk, we determined the risk for fraud to be too high and we were unable to apply other procedures to overcome this fraud risk. In addition, the Fiscal Court had serious weaknesses in the design and operation of its internal control procedures and accounting functions. Furthermore, management elected to override the internal control procedures that were in place. We were unable to apply audit procedures to test for appropriate compliance with statutory, contractual, and administrative regulations as well as with federal grant agreements, Governor's Office for Local Development (GOLD) requirements, and county administrative code requirements. Because of this, we were also unable to determine if ethics violations occurred. In addition, we were denied access to fiscal court records needed to adequately conduct our procedures due to the county's failure to provide certain requested documentation. The significance of these issues, in the aggregate, prevents us from placing any reliance on the financial activities contained in the Fourth Quarterly Report of the Fiscal Court.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Knott County's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the Fourth Quarterly Report and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Knott County's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items: 2004-12, 2004-13, 2004-14, 2004-15, 2004-16, and 2004-17.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider all of them to be material weaknesses.



Report On Internal Control Over Financial Reporting And On  
Compliance And Other Matters Based On An Audit Of Financial  
Statements Performed In Accordance With Government Auditing Standards  
(Continued)

Compliance And Other Matters

As part of obtaining reasonable assurance about whether Knott County's Fourth Quarterly Report is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under Government Auditing Standards and which are described in the accompanying schedule of findings and questioned costs as items: 2004-01, 2004-02, 2004-03, 2004-04, 2004-05, 2004-06, 2004-07, 2004-08, 2004-09, 2004-10, and 2004-11.

This report is intended solely for the information and use of management and the Kentucky Governor's Office for Local Development and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Crit Luallen", with a long horizontal flourish extending to the right.

Crit Luallen  
Auditor of Public Accounts

Audit fieldwork completed -  
September 27, 2005



**REPORT ON COMPLIANCE WITH REQUIREMENTS  
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL  
CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**





CRIT LUALLEN  
AUDITOR OF PUBLIC ACCOUNTS

The Honorable Donnie Newsome, Former Knott County Judge/Executive  
Members of the Knott County Fiscal Court

Report On Compliance With Requirements  
Applicable To Each Major Program And On Internal Control  
Over Compliance In Accordance With OMB Circular A-133

Compliance

We have audited the compliance of Knott County, Kentucky, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2004. Knott County's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Knott County's management. Our responsibility is to express an opinion on Knott County's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Knott County's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Knott County's compliance with those requirements.

As described in items 2004-18, 2004-19, and 2004-20 in the accompanying schedule of findings and questioned costs, Knott County Fiscal Court did not comply with requirements regarding activities allowed or unallowed, allowable costs, cash management, matching/level of effort/earmarking, procurement/suspension/debarment, and reporting that are applicable to its major program, Federal Emergency Management Agency (FEMA). Compliance with such requirements is necessary, in our opinion, for Knott County Fiscal Court to comply with requirements applicable to that program.

In our opinion, because of the effects of the noncompliance described in the preceding paragraph, Knott Count Fiscal Court did not comply in all material respects, with the requirements referred to above that are applicable to FEMA.



Report On Compliance With Requirements  
Applicable To Each Major Program And On Internal Control  
Over Compliance In Accordance With OMB Circular A-133  
(Continued)

Internal Control Over Compliance

The management of Knott County is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Knott County's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect Knott County Fiscal Court's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. A reportable condition is described in the accompanying schedule of findings and questioned costs as item 2004-21.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider the reportable condition described above to be a material weakness.

This report is intended solely for the information and use of management, federal awarding agencies, and pass-through entities, and is not intended to be, and should not be, used by anyone other than these specified parties.

Respectfully submitted,



Crit Luallen  
Auditor of Public Accounts

Audit fieldwork completed -  
September 27, 2005

